Could market reactions guide Brexit votes?

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Russell Investments,

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- Markets unnerved as prospects for Brexit agreement remain uncertain
- Is fiscal stimulus in China offsetting the impact of U.S. tariffs?
- Jerome Powell weighs in on state of U.S. economy

Tumultuous week in UK as Brexit saga continues

The week of November the 12th was a political rollercoaster on the Brexit front, Ng said, beginning with the publication of a draft withdrawal agreement — between UK Prime Minister Theresa May and EU leaders — spelling out the terms of Britain's looming exit from the EU. UK bond yields and the British pound initially rose on the 14th of November upon the news that May had secured cabinet approval of the deal — only to plummet the next day when a string of ministers resigned in protest over the proposed agreement.

"As measured against the U.S. dollar, sterling at one point was down 2% on the 15th of November," Ng noted, adding that the volatility also spread to UK equity markets, with the FTSE 100 off 2% at week's end, in comparison to the previous week. The uncertainty plaguing the Brexit talks has been quite disruptive to businesses, she said, because neither Britain or the EU are prepared for a *no-deal* Brexit — and yet such an outcome remains possible.

In the view of Ng and the team of Russell Investments strategists, however, the more likely scenario is that the British Parliament will eventually approve the Brexit deal — meaning the UK would leave the EU on the 29th of March 2019, with a withdrawal agreement in place. Why? "We see parallels between the initial reaction to the Troubled Asset Relief Program (TARP) by the U.S. Congress in 2008, and the proposed Brexit deal's reception in Parliament," Ng said, explaining that Congress first rejected TARP, only to approve the legislation days later following severe negative reaction in U.S. markets.

"Along these lines, our thinking is that even if Parliament initially rejects the Brexit deal, it likely will be forced to vote on it again, as markets will probably go haywire if it's turned down," she said. In short, while things may get worse before they get better, Ng expects for an agreement on Brexit to ultimately be approved — and for sterling to re-strengthen over the next 12 months.

Are U.S. tariffs hurting China's economy?

Turning to China, Ng said that there are two forces impacting the country's growth: trade policy, which is acting as a headwind, and government stimulus, which is serving as a tailwind. The latest economic data released by the Chinese government is mildly encouraging as it relates to growth, Ng said, as the numbers show that government stimulus is starting to offset the impact of China's trade war with the U.S. "Increased infrastructure spending in China boosted industrial production and fixed asset investment — both of which came in ahead of consensus expectations," she noted.

On the flip side, the numbers surrounding money supply and credit loan growth were disappointing, in Ng's opinion — and she doesn't foresee any boost to the country's credit sector going forward. "This is because China is concentrating more on fiscal stimulus, rather than monetary policy, in order to counteract the negative impacts of trade clashes with the U.S. and curb its economic slowdown," she explained.

U.S. economy in great shape, Fed chair says

Shifting to the Fed, Ng said that Chair Jerome Powell's 14th of November remarks at the Federal Reserve Bank of Dallas were much more balanced — in contrast to his hawkish October comments regarding U.S. interest rates. "This time, Powell stated that he's quite happy with the current strength of the U.S. economy — and noted that the recent equity market selloff wasn't enough to change the central bank's plans to continue raising interest rates at a quarterly pace," Ng said. The Fed chair, however, did flag slowing global growth as a risk going forward, she stated.

"At Russell Investments, we largely agree with Powell's remarks," Ng said, "as the U.S. economy remains in good shape." She noted that in her opinion, the recent slowdown in global growth was likely due to more temporary factors, such as bad weather in Japan and a change in emission standards that disrupted manufacturing activity in Europe. "We expect that global growth will stage a rebound this quarter — and that the Fed will continue raising interest rates at a steady pace," she concluded.

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